CERTIFICATE.

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1915.

No. 291.

FARMERS' & MECHANICS' NATIONAL BANK OF PHILADELPHIA

vs.

RIDGE AVENUE BANK ET AL.

ON A CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

FILED NOVEMBER 28, 1914.

(24,448)

(24,448)

SUPREME COURT OF THE UNITED STATES.

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INDEX.

	Original.	Print
Certificate from the United States circuit court of appeals for the third circuit	1	1
Statement	1	1
Question certified	3	2
Judges' certificate	3	2
Clerk's certificate	4	2

JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., AUGUST 11, 1915.

1 In the United States Circuit Court of Appeals for the Third Circuit.

No. 1811, March Term, 1914.

FARMERS' & MECHANICS' NATIONAL BANK OF PHILADELPHIA
vs.
RIDGE AVENUE BANK et al.

From the District Court of the United States for the Eastern District of Pennsylvania.

In Bankruptcy.

Appeal and Petition to Revise.

Before Buffington and Hunt, Circuit Judges, and Witmer, District Judge.

In order to be guided to a proper decision of the controversy appearing upon this record, the Circuit Court of Appeals for the Third Circuit desires the instruction of the Supreme Court, and accordingly certifies the following question under Section 239 of the Judicial Code:

On November 21, 1910, the firm of William Gray & Sons and each of its three partners were adjudged bankrupt by the District Court of the United States for the Eastern District of Pennsylvania. The three partners were William J. Gray, Alexander J. Gray, and Peter Gray. The same person was appointed trustee both of the
2 firm estate and of the individual estate of each partner. He filed separate accounts with the referee showing separate balances in his hands, these balances arising from the partnership estate and also from the individual estates of William J. Gray and of Alexander J. Gray respectively. There were no individual assets and no balance arising from the estate of Peter Gray.

The trustee's accounts contained no credits for expenses of administration, and when the accounts came to be considered before the referee these expenses were allowed without objection from any creditor either of the firm or of either partner. The result of these allowances was this: (1) The balance shown upon the trustee's account of the firm estate was wholly applied to the proper administration expenses; (2) The balance appearing upon the account of William J. Gray's estate was also applied wholly to these expenses (no creditor filed a claim against the individual estate of William J. Gray); (3) a portion of the balance in the individual estate of Alexander J. Gray was also applied to these expenses, leaving

$1,597.26 in the hands of the trustee arising from the individual estate of Alexander J. Gray.

The dispute concerns the proper distribution of this amount. A number of creditors proved their claims against the firm—among others, the Ridge Avenue Bank of Philadelphia. No creditor proved a claim against the individual estate of William J. Gray. Only one creditor—the Farmers' & Mechanics' National Bank of Philadelphia—proved a claim against the individual estate of Alexander J. Gray, and this claim was larger than $1,597.26. The firm was insolvent, each individual member was insolvent, and no partnership funds were available for distribution among firm creditors, the only fund for distribution being derived from the individual estate of Alexander J. Gray. The district court entered a decree directing the fund to be distributed pari passu between the Farmers' &
3 Mechanics' National Bank and the firm creditors of William J. Gray & Sons.

The question of law on which the Court of Appeals desires the instruction of the Supreme Court is this:

When a partnership as such is insolvent, and when each individual member is also insolvent, and when the only fund for distribution is produced by the individual estate of one member, are the individual creditors of such member entitled to priority in the distribution of the fund?

Nov. 12th, 1914.

(Signed) JOS. BUFFINGTON,
WILLIAM H. HUNT.
CHARLES B. WITMER,
Judges.

Endorsed: No. 1811. Certificate of Questions to Supreme Court of U. S. Received & Filed Nov. 16, 1914. Saunders Lewis, Jr., Clerk.

4 UNITED STATES OF AMERICA,
Eastern District of Pennsylvania,
Third Judicial Circuit, sct:

I, Saunders Lewis, Jr., Clerk of the United States Circuit Court of Appeals, for the Third Circuit, do hereby Certify the foregoing to be a true and faithful copy of the original certificate of questions to the Supreme Court of the United States, in the case of Farmers' & Mechanics' National Bank of Philadelphia, Petitioner, vs. Ridge Avenue Bank et al., Respondents, on file, and now remaining among the records of the said Court, in my office.

In Testimony Whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia, this eighteenth day of November in the year of our Lord one thousand nine hundred

and fourteen and of the Independence of the United States the one hundred and thirty-ninth.

[Seal United States Circuit Court of Appeals, Third Circuit.]

SAUNDERS LEWIS, JR.,
Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

[Endorsed:] No. —. —— Term, 191–. United States Circuit Court of Appeals, Third Circuit. Certified Copy.

Endorsed on cover: File No. 24,448. U. S. Circuit Court Appeals, 3d Circuit. Term No. 291. Farmers' & Mechanics' National Bank of Philadelphia vs. Ridge Avenue Bank et al. (Certificate.) Filed November 23d, 1914. File No. 24,448.

Office Supreme Court, U. S.
FILED
DEC 28 1914
JAMES D. MAHER
CLERK

IN THE

Supreme Court of the United States

October Term, 1914. No. 704. 291

THE FARMERS' AND MECHANICS' NATIONAL BANK OF PHILADELPHIA,

Petitioner,

v.

RIDGE AVENUE BANK and CHESTER P. RAY, Trustee of Estate of William J. Gray, Peter Gray and Alexander J. Gray, Individually and and as Co-partners, Trading as William Gray & Sons, Bankrupts,

Respondents.

Petition for Writ of Certiorari to United States Circuit Court of Appeals for the Third Circuit, to Require the Whole Record and Cause to be Sent Up to the Supreme Court, Together With Copy of Certificate of Said Court of Appeals.

J. FRANK STALEY,
JOHN F. LEWIS,
LEWIS, ADLER & LAWS,
Counsel for Petitioner.

International, 236 Chestnut St.

IN THE

Supreme Court of the United States

October Term, 1914. No. 704.

THE FARMERS' AND MECHANICS' NATIONAL BANK OF PHILADELPHIA,

Petitioner,

v.

RIDGE AVENUE BANK AND CHESTER P. RAY, TRUSTEE OF ESTATE OF WILLIAM J. GRAY, PETER GRAY AND ALEXANDER J. GRAY, INDIVIDUALLY AND AS CO-PARTNERS TRADING AS WILLIAM GRAY & SONS, BANKRUPTS,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT, TO REQUIRE THE WHOLE RECORD AND CAUSE TO BE SENT UP TO THE SUPREME COURT, TOGETHER WITH COPY OF CERTIFICATE OF SAID COURT OF APPEALS.

To the Honorable the Judges of the Supreme Court of the United States:

The petition of The Farmers' and Mechanics' National Bank of Philadelphia respectfully alleges and verifies:

First.—That in a certain cause in bankruptcy entitled The Farmers' and Mechanics' National Bank of Philadelphia, Appellant, v. Ridge Avenue Bank and Chester P. Ray, Trustee of Estate of William J. Gray, Bankrupt, Appellees, then pending in the United States Circuit Court of Appeals for the Third Circuit, the Honorable Judges of said Circuit Court of Appeals have certified to this court, which certificate is docketed

for this term, a certain question or proposition of law concerning which said Circuit Court of Appeals desires the instruction of this court. A copy of said certificate is appended hereto and made part of this petition.

Second.—That the question or proposition of law upon which the said Circuit Court of Appeals desires the instruction of this court, requires the application, interpretation and effect to be given to section 5, clauses F and G of the Bankruptcy Act of 1908, in the distribution of a partner's individual assets between such partner's individual creditors and the partnership creditors, there being no partnership assets for distribution, in a proceeding where the partnership and the individual partners are in bankruptcy.

That the application, interpretation and effect to be given to the said clauses of section 5 of the Bankruptcy Act require a full discussion of the question whether or not this court will adopt, in a bankruptcy proceeding, an equitable theory or doctrine marshalling a partner's individual assets between partnership creditors and such partner's individual creditors. That the application of such a theory or doctrine as the correct rule was advanced by the respondents when the question arose in the District Court for the Eastern District of Pennsylvania and was adopted by that court, and was also advanced in the argument on appeal before the said Circuit Court of Appeals, and it is believed that the same contention will be made by the respondents in this court.

Third.—That the whole cause of action and the entire history of the controversy arising during the course of the administration of the said bankruptcy proceedings, are fully shown by the pleadings constituting the transcript of record filed in the said Circuit Court of Appeals, and, if any equitable theory for the marshalling of assets between partnership cred-

itors and partner's individual creditors in bankruptcy proceedings is to receive the consideration of this court, the said transcript of record ought to be before it for review, as such transcript of record, in addition to the facts as stated in the certificate of the said Circuit Court of Appeals, contains *inter alia* a full history of the proceedings and the relation of all the parties, itemized statements of the balances appearing in the several accounts, and specific items of expense of administration allowed by the referee during the course of the proceeding, an examination of which discloses substantial partnership assets available for firm creditors but distributed solely in large administration expenses, leaving no net proceeds for distribution among firm creditors; and, further, that the said transcript of record contains the schedules of distribution in the several estates, made by the referee, and other important records showing how the question of distribution arose before the referee, in the District Court, and in the said Circuit Court of Appeals. A certified copy of the said transcript of record, together with all proceedings had in the said Circuit Court of Appeals, is herewith submitted.

Your petitioner, therefore, representing that the question so certified to this court by the said Circuit Court of Appeals does not embrace all of the factors necessary to a full determination of the question or proposition involved in the cause, prays this court to require the whole record in the cause to be sent to this court for its consideration.

THE FARMERS' AND MECHANICS' NATIONAL BANK OF PHILADELPHIA,

By

HOWARD W. LEWIS,
President.

J. FRANK STALEY,
JOHN F. LEWIS,
Of Counsel.

IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

Farmers' and Mechanics' National Bank of Philadelphia,
v.
Ridge Avenue Bank, et al.

No. 1811.
March Term, 1914.

FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE EASTERN DISTRICT OF PENNSYLVANIA. IN BANKRUPTCY.

APPEAL AND PETITION TO REVISE.

Before BUFFINGTON and HUNT, Circuit Judges, and WITMER, District Judge.

In order to be guided to a proper decision of the controversy appearing upon this record, the Circuit Court of Appeals for the Third Circuit desires the instruction of the Supreme Court, and accordingly certifies the following question under Section 239 of the Judicial Code:

On November 21, 1910, the firm of William Gray & Sons and each of its three partners were adjudged bankrupt by the District Court of the United States for the Eastern District of Pennsylvania. The three partners were William J. Gray, Alexander J. Gray and Peter Gray. The same person was appointed trustee both of the firm estate and of the individual estate of each partner. He filed separate accounts with the referee showing separate balances in his hands, these balances arising from the partnership estate and also from the individual estates of William J. Gray and of Alexander J. Gray respectively. There were no individual assets and no balance arising from the estate of Peter Gray.

The trustee's accounts contained no credits for expenses of administration, and when the accounts came to be considered before the referee these expenses were allowed without objection from any creditor either of the firm or of either partner. The result of these allowances was this: (1) The balance shown upon the trustee's account of the firm estate was wholly applied to the proper administration expenses; (2) The balance appearing upon the account of William J. Gray's estate was also applied wholly to these expenses (no creditor filed a claim against the individual estate of William J. Gray); (3) A portion of the balance in the individual estate of Alexander J. Gray was also applied to these expenses, leaving $1597.26 in the hands of the trustee arising from the individual estate of Alexander J. Gray.

The dispute concerns the proper distribution of this amount. A number of creditors proved their claims against the firm—among others, the Ridge Avenue Bank of Philadelphia. No creditor proved a claim against the individual estate of William J. Gray. Only one creditor—the Farmers' and Mechanics' National Bank of Philadelphia—proved a claim against the individual estate of Alexander J. Gray, and this claim was larger than $1597.26. The firm was insolvent, each individual member was insolvent, and no partnership funds were available for distribution among firm creditors, the only fund for distribution being derived from the individual estate of Alexander J. Gray. The District Court entered a decree directing the fund to be distributed *pari passu* between the Farmers' and Mechanics' National Bank and the firm creditors of William Gray & Sons.

The question of law on which the Court of Appeals desires the instruction of the Supreme Court is this:

When a partnership as such is insolvent, and when each individual member is also insolvent, and

when the only fund for distribution is produced by the individual estate of one member, are the individual creditors of such member entitled to priority in the distribution of the fund?

JOS. BUFFINGTON,
WILLIAM H. HUNT,
CHARLES B. WITMER,
Judges.

November 12, 1914.

UNITED STATES OF AMERICA,
EASTERN DISTRICT OF PENNSYLVANIA, } *sct.:*
THIRD JUDICIAL CIRCUIT,

I, Saunders Lewis, Jr., Clerk of the United States Circuit Court of Appeals, for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original question to be certified to the Supreme Court of the United States, in the case of Farmers' and Mechanics' National Bank of Philadelphia, Appellant, and Ridge Avenue Bank and Chester P. Ray, Trustee of Estate of William J. Gray, Bankrupt, Appellees, on file and now remaining among the records of the said Court, in my office.

IN TESTIMONY WHEREOF, I have hereunto subscribed my name and affixed the seal of the said court, at Philadelphia, this 15th day of December, in the year of our Lord one thousand nine hundred and fourteen, and of the Independence of the United States the one hundred and thirty-ninth.

(Seal)

SAUNDERS LEWIS, JR.,
Clerk of the U. S. Circuit Court of Appeals, Third Circuit.

Office Supreme Court, U. S.
FILED
MAR 6 1916
JAMES D. MAHER
CLERK

IN THE

Supreme Court of the United States.

October Term, 1915. **No. 291.**

THE FARMERS' AND MECHANICS' NATIONAL BANK OF PHILADELPHIA,

Petitioner-Appellant,

v.

RIDGE AVENUE BANK and CHESTER P. RAY, Trustee of the Estate of WILLIAM J. GRAY, PETER GRAY and ALEXANDER J. GRAY, Individually and as Co-partners, Trading as WILLIAM GRAY & SONS, Bankrupts,

Respondents-Appellees.

On a Certificate from the United States Circuit Court of Appeals for the Third Circuit.

BRIEF ON BEHALF OF PETITIONER-APPELLANT.

J. FRANK STALEY,
LEWIS, ADLER & LAWS,
Counsel for Petitioner-Appellant.

INDEX.

	Page
Nature of Proceedings and Question Certified	1
Statement of Facts	2
Argument	3
Clauses "f" and "g" of Bankruptcy Act, 1898	3
Cases Cited:	
Conrader v. Cohen, 121 Fed. 801	13
In re Daniels, 110 Fed. 745	9
In re Downing, 7 Fed. Cas. No. 4044	14
Euclid National Bank v. Union Trust Company, 149 Fed. 975, Certiorari Denied 205 U. S. 547	6
In re Hull, 224 Fed. 796	9
In re Janes, 133 Fed. 912, Certiorari Denied Under Name MacNabb, Trustee, v. Bank of LeRoy, 198 U. S. 583	5
Miller v. New Orleans Fertilizer Co., 211 U. S. 496	10
Mills v. J. H. Fisher Co., 159 Fed. 897	8
Murrill v. Neill, 8 How. 414	11
In re Mills, 95 Fed. 269	9
U. S. v. Lewis, 92 U. S. 618	14
In re Wilcox, 94 Fed. 84	8

IN THE

Supreme Court of the United States.

October Term, 1915. No. 291.

THE FARMERS' AND MECHANICS' NATIONAL BANK OF PHILADELPHIA,

Petitioner-Appellant,

v.

RIDGE AVENUE BANK AND CHESTER P. RAY, TRUSTEE OF ESTATE OF WM. J. GRAY; PETER GRAY AND ALEXANDER J. GRAY, INDIVIDUALLY, AND AS CO-PARTNERS, TRADING AS WILLIAM GRAY & SONS, BANKRUPTS,

Respondents-Appellees.

BRIEF ON BEHALF OF PETITIONER-APPELLANT.

I.

NATURE OF PROCEEDINGS AND QUESTION CERTIFIED.

The Circuit Court of Appeals for the Third Circuit, under Section 239 of the Judicial Code, asks the instruction of this Court upon the following question of law:

> "When a partnership as such is insolvent, and when each individual member is also insolvent, and when the only fund for distribution is pro-

duced by the individual estate of one member, are the individual creditors of such member entitled to priority in the distribution of the fund?"

II.

STATEMENT OF FACTS.

The facts stated in the certificate are:

"On November 21, 1910, the firm of William Gray & Sons and each of its three partners were adjudged bankrupt by the District Court of the United States for the Eastern District of Pennsylvania. The three partners were William J. Gray, Alexander J. Gray and Peter Gray. The same person was appointed trustee both of the firm estate and of the individual estate of each partner. He filed separate accounts with the Referee showing separate balances in his hands, these balances arising from the partnership estate and also from the individual estates of William J. Gray and of Alexander J. Gray respectively. There were no individual assets and no balance arising from the estate of Peter Gray.

The trustee's accounts contained no credits for expenses of administration, and when the accounts came to be considered before the Referee these expenses were allowed without objection from any creditor either of the firm or of either partner. The result of these allowances was this: (1) The balance shown upon the trustee's account of the firm estate was wholly applied to the proper administration expenses; (2) The balance appearing upon the account of William J. Gray's estate was also applied wholly to these expenses (no creditor filed a claim against the individual estate of William J. Gray); (3) A portion of the balance in the individual estate of Alexander J. Gray was also applied to these expenses, leaving $1597.26 in the hands of the trustee arising from the individual estate of Alexander J. Gray.

The dispute concerns the proper distribution of this amount. A number of creditors proved their claims against the firm—among others, the Ridge Avenue Bank of Philadelphia. No creditor proved a claim against the individual estate of William J. Gray. Only one creditor—the Farmers' and Mechanics' National Bank of Philadelphia—proved a claim against the individual estate of Alexander J. Gray, and this claim was larger than $1597.26. The firm was insolvent, each individual member was insolvent, and no partnership funds were available for distribution among firm creditors, the only fund for distribution being derived from the individual estate of Alexander J. Gray. The District Court entered a decree directing the fund to be distributed *pari passu* between the Farmers' and Mechanics' National Bank and the firm creditors of William Gray & Sons."

III.

ARGUMENT.

The provisions of the bankruptcy law of July 1, 1898, 30 Stat. at Large, Chap. 541, page 544, and its supplements, regulating the administration and distribution of partnership property and the property of the individual partners where the firm and the partners are all in bankruptcy, are found in Section 5 of the Act; sub-sections "f" and "g" of this section read as follows:

"(f) The net proceeds of the partnership property **shall be appropriated** to the payment of the partnership debts, **and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner** after paying **his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts.** Should any surplus

of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership.

"(g) The Court may permit the proof of the claim of the partnership estate against the individual estates, and vice versa, and may marshal the assets of the partnership estate and individual estates so as to prevent preferences and secure the equitable distribution of the property of the several estates."

There is a seeming conflict among the decisions of the several Circuit Courts of Appeals as to the true rule of distribution to be applied in bankruptcy proceedings, where the partnership and all the individual members thereof are insolvent, where there are no firm assets for distribution, and the only fund for distribution is produced by the individual estate of one member. The Circuit Court of Appeals for the Second, Fourth and Sixth Circuits apply strictly the rule of distribution provided for in sub-section "f" above quoted, and distribute the fund produced by the individual estate of one partner as a priority among the individual creditors of such partner, to the exclusion of firm creditors. The Circuit Court of Appeals for the Third Circuit, under an unusual state of facts, distributes the assets of such individual partner *pari passu* between firm creditors and the individual creditors of such partner.

The question certified to this Court is intended to secure the proper interpretation or construction to be given the clauses of the bankruptcy act above quoted, and to have established a uniform rule of distribution of a partner's individual estate between firm and individual creditors where the partnership and all partners are in bankruptcy, and the only assets available for creditors are the assets of one of the individual partners.

IV.

RULE OF DISTRIBUTION IN THE CIRCUIT COURTS OF APPEALS FOR THE SECOND, FOURTH AND SIXTH CIRCUITS.

It is urged that *clause "f" lays down a positive and direct rule of distribution* and requires the appropriation of the net proceeds of the individual estate of each partner to the payment of such individual debts, and partnership creditors are entitled to share therein only after such individual debts have been paid in full. The existence or non-existence of firm assets for distribution cannot affect or vary the rule.

In re Janes, 133 Fed. 912 (C. C. A. Second Circuit, 1904), partnership and individual members thereof were insolvent, no firm assets, firm creditors and individual creditors duly proved their claims. The District Court, in an opinion reported in 128 Fed. 527, distributed the assets of the individual estates *pari passu* between firm creditors and the creditors of the individual partners. On appeal, the judgment of the District Court was reversed, and distribution directed to be made solely among the creditors of such individual partners. Judge Lacombe, Circuit Court Judge, after stating the facts, said:

> "We are of the opinion that the rule to be applied is the rule laid down in the sections above quoted from the bankrupt act. **It was within the discretion of Congress to leave this subject of the marshalling of assets to the courts, to be disposed of in accordance with equity principles and practice, or to provide that the general rule should be modified in particular cases. It has done neither. On the contrary, it has itself directed how the assets shall be marshalled, and it has done so in language broadly covering this case as well as all the others. The language is plain, explicit and unambiguous; it names no 'exception'; its phraseology conveys no intimation that any 'exception' is**

> **contemplated. To inject into the act an excepting clause where none has been enacted would seem to be judicial legislation.** For this reason, we have reached the conclusion above expressed.
>
> "The order under review is reversed, and the cause remanded, with instructions to marshal the assets in accordance with the directions of the bankruptcy act."

A petition for a writ of certiorari to review this decision was presented to this Court under the name of MacNabb, Trustee v. The Bank of LeRoy, 198 U. S. 583, *and the writ was denied.*

In *Euclid National Bank v. Union Trust and Deposit Company, Trustee,* reported in 149 Fed. 975 (C. C. A. Fourth Circuit, 1906, affirming the opinion of the District Court, reported under the name of *In Re Henderson,* 142 Fed. 588), firm and individuals were all in bankruptcy. There were individual assets for distribution, but no firm assets; individual assets were distributed among individual creditors to the exclusion of firm creditors. The Court in making distribution said, at page 977:

> **"The language of sub-section (f) would seem to be too clear to admit of serious doubt as to its meaning, namely, that the estate of the individual bankrupt should be first applied to individual debts, and those of the firm to the firm debts, and that only the surplus of the estate over and above what was necessary to pay the individual debts on the one hand, or the firm creditors on the other, could be used and applied alike to the payment and adjustment of the individual and partnership debts, as the case may be. Indeed, the act plainly limits this latter application of the assets to the surplus thereof, as distinguished from the estate generally.** The contention, however, is earnestly made that notwithstanding the clear and unambiguous provisions of the act, and the apparent justice thereof, a different rule should be adopted, and an exception made in cases where there is no

partnership estate, and that in such a contingency the firm creditors have a right to share along *pari passu* with the individual creditors, in the distribution of the latter estate. The question thus raised is not a new one, either under this or the former bankruptcy acts, and has given rise to much discussion in this country and in England, resulting in many conflicting decisions, and an apparently hopeless confusion of the subject. We are disinclined to enter into a general discussion of the various and irreconcilable opinions found in the reported cases. The decision of Judge Lowell in Re Wilcox (D. C.), 94 Fed. 84, contains an extended review of the entire subject, and especially a history of the law, to which we take the liberty of referring. The Circuit Court of Appeals of two of the circuits have taken antagonistic views of the present bankruptcy act. In Conrader v. Cohen, 121 Fed. 801, 58 C. C. A. 249, a decision of the Circuit Court of Appeals for the Third Circuit, the petitioners' right to share as partnership creditors in the individual assets of the bankrupt is fully recognized; and in re Janes, 133 Fed. 912, 67 C. C. A. 216, a decision of the Circuit Court of Appeals for the Second Circuit the contrary view is taken. A careful consideration of the entire subject and review of the authorities convinces this court that, whatever may have been the correct rule under former bankruptcy acts, the latter case, a decision of Judge Lacombe, of the Second Circuit, concurred in by Judges Wallace and Townsend, presents the correct construction of the law under the present act; and, however much force there may have been in the contention made by petitioners under the former bankruptcy acts, or what may be the correct general doctrine applicable to the settlement and distribution of partnership estates, that it was clearly within the power of Congress to adopt a method for marshalling such assets, to be applied to the respective classes of creditors, which it has done, and in terms too clear and comprehensive to admit of the necessity for interpretation further than to adopt and follow its plain mandates.

> **To ingraft upon the act the exception sought to be maintained by the petitioners would be manifestly improper on the part of the court, and in the language of Judge Lacombe in Re Janes, supra, would be judicial legislation.** An able discussion on the subject will be found in the opinion of the lower Court (128 Fed. 527), to which we refer, as also to In re Mills (D. C.), 95 Fed. 269, and In re Corcoran, 12 Am. Bankr. Rep. 283."

A petition for writ of certiorari to review this decision was presented to this Court, but the writ was again denied, 205 U. S. 547.

In Mills v. J. H. Fisher & Co., 159 Fed. 897 (C. C. A. Sixth Circuit, 1908), opinion by Mr. Justice Lurton, the rule of distribution is thus stated, page 900:

> "That the members of the firm were each liable in solido for the joint debts is not disputable. Undoubtedly the individual creditors of John H. Fisher would be preferred over the joint creditors out of his individual estate. But, if there were none, then the whole of that separate property would have been subject to the demands of the joint creditors. If there were such separate creditors, then the right of the joint creditors to the surplus, after paying the other class of debts, is not deniable. *That this preference of the individual creditor exists, independently of the existence of partnership assets, under the bankrupt act 1898, may be conceded upon the reasoning and authority of In re Wilcox* (D. C.), 94 Fed. 84; In re Janes, 133 Fed. 912, 67 C. C. A. 216, and Euclid Nat. Bank v. Union Trust & Deposit Co., 149 Fed. 975, 79 C. C. A. 485."

The same rule of distribution has been applied by the District Court for the Districts of *Massachusetts, Indiana, Rhode Island and Ohio.* The opinions in these cases are full and instructive. Judge Lowell, in the case of *In re Wilcox,* 94 Fed. 84 (District Court of Massachusetts, 1899), in an opinion covering twenty-

four pages of the Federal Reporter, reviews the history of the law on the subject, and his opinion has frequently been referred to as a monograph of such law. See also *In re Mills*, 95 Fed. 269 (District Court of Indiana, 1899); *In re Daniels*, 110 Fed. 745 (District Court of Rhode Island, 1901); *In re Hull*, 224 Fed. 796 (District Court of Ohio, 1915).

District Court Judge Killets, whose opinion is the last judicial expression, in the case of In re Hull, supra, says, page 799:

> "Indeed, it is difficult to see wherein the language of paragraph 'f' of Section 5 permits the grafting of an exception. The first sentence so definitely provides how various classes of debts shall be paid as to seem to leave no room for any variation. It reads:
>
> > " 'The net proceeds of the partnership property shall be appropriated for the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts.'
>
> "This language, read literally, excludes opportunity for the partnership debts to participate in the fund derived from the individual estate of a partner, except as provided in the subsequent sentence of the paragraph; that is, only when the individual estate yields a surplus above the individual liabilities. In the absence of an authoritative holding in this circuit, it seems to us that the better course is to follow the second and fourth circuits, already cited, and to hold that the statute is so definite as to provide a uniform rule of distribution, against which there can be no exception introduced by judicial construction."

The only theory advanced that could possibly prevent the strict application of the rule provided for in clause "f" is that clause "g" qualifies clause "f" and permits the application of an exception and different rule where there are no firm assets for distribution. This doctrine has frequently been called the exception

to the general rule as practiced in the Courts of Chancery in England, but which has never been recognized by this Court. Clause "f", however, in positive and unmistakable terms, lays down the rules or schedules for distribution, and anything permissible by virtue of clause "g", cannot vary the positive commands of distribution as prescribed by clause "f". Clause "g", as it has been applied, only becomes operative in so far as it assists or regulates the administration of the several estates, by permitting proofs of claims of partnership debts against the individual estate, by preventing preferences, by regulating the manner and items of accounting, and doing equity as the facts and circumstances require. The clause has reference solely to the administration and accounting in the estates, but after such administration and an accounting of the assets in the estate to which they properly or equitably belong have been had, and all that remains is the distribution of the net proceeds of the several estates among the creditors, then distribution must be made in the manner required by section "f". The facts stated in the present certificate do not contemplate or show any unusual circumstance or special equity.

Clauses "f" and "g" have been discussed by this Court in two cases: *Miller v. New Orleans Fertilizer Co.*, 211 U. S. 496; *Francis v. McNeal*, 228 U. S. 695. In *Miller v. New Orleans Fertilizer Co.*, at page 503, Mr. Chief Justice White, speaking for this Court, said:

> "*Thus, sub-division 'f' of Section 5 commands* that 'the net proceeds of the partnership property shall be appropriated to the payment of the partnership debts, and the net proceeds of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to

the partnership assets and be applied to the payment of the partnership debts. *To enforce these provisions the act* compels (sub. d) the keeping of separate accounts of the partnership property and of the property belonging to the individual partners; the payment (sub. e) of the bankrupt expenses as to the partnership and as to the individual property proportionately; and permits (sub. g) the proof of the claim of the partnership estate against the individual estate and vice versa, and directs the marshalling of the assets of the partnership estate and the individual estates, 'so as to prevent preferences and secure the equitable distribution of the property of the several estates.'"

Historically, the rule of distribution provided by clause "f" is the re-enactment of the rule in equity governing the administration of the estates of insolvent partners, which has been in practice from the beginning of our judicial history. This Court, in the case of Murrill et al. v. Neill et al., 8 Howard 414, had occasion to review the history of such rule, and at page 425 said:

> "The rule in equity governing the administration of insolvent partnerships is one of familiar acceptation and practice; it is one which will be found to have been in practice in this country from the beginning of our judicial history, and to have been generally, if not universally, received. This rule, with one or two eccentric variations in the English practice which may be noted hereafter, is believed to be identical with that prevailing in England, and is this: That partnership creditors shall in the first instance be satisfied from the partnership estate, and separate or private creditors of the individual partners from the separate and private estate of the partners with whom they have made private and individual contracts; and that the private and individual property of the partners shall not be applied in extinguishment of

> partnership debts, until the separate and individual creditors of the respective partners shall be paid. The reason and foundation of this rule, or its equality and fairness, the Court is not called on to justify. Were these less obvious than they are, it were enough to show the early adoption and general prevalence of this rule, to stay the hand of innovation at this day; at least, under any motive less strong than the most urgent propriety."

After reviewing the history of the rule in England, the opinion called attention to the departure from the general rule permitted by the Court of Chancery in England in cases where there were no joint effects at all and said, at page 427:

> "It may be proper in this place to mention the two departures permitted by the Court of Chancery in England from the general rule pursued by that Court, which departures were adverted to in a previous part of this opinion. The first is presented in the instance in which the petitioning creditor, though a joint creditor, is permitted to charge the separate effects *pari passu* with the separate creditors, because, as it is said, his petition, being prior in time, is in the nature of an execution in behalf of himself and the separate creditors. *The second is that in which there are no joint effects at all.* In this last instance it is said that the joint creditors may come in for dividends *pari passu* on the separate effects; though if there be joint effects, though of the smallest possible amount, this privilege would not be allowed. *These exceptions it seems difficult to reconcile with the reason or equity on which the general rule is founded; they are but exceptions, however, and cannot impair that rule. They do not, for aught we have seen, appear to have been recognized by the courts of this country.*"

This case has never been overruled, nor has there been any other case in this Court which has established a contrary doctrine.

In the search made by counsel, wherever clause "g" has been interpreted and applied by the courts it has always been in the active administration and accounting of the several bankrupt estates, and in no case has it been applied to the distribution of assets after administration and full accounting have been had. The question certified relates solely to distribution of assets after administration and accounting.

V.

RULE OF DISTRIBUTION IN THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

The Honorable John B. McPherson, Circuit Court Judge, sitting in the District Court for the Eastern District of Pennsylvania, in the present case, reported in 208 Fed. 960, directed the distribution of the net proceeds of the individual estate of one of the partners, there being no firm assets, *pari passu* among firm creditors and the individual creditors of such partner, because he believed that such distribution must be made in accordance with the rule laid down in the case of *Conrader v. Cohen,* 121 Fed. 801 (1903), affirming the distribution made by the District Court in an opinion by the Honorable Joseph Buffington, then sitting in the District Court, reported in 118 Fed. 676. In that case the facts were unusual. *The firm was not in bankruptcy.* Jenkins and Conrader were partners, trading as Jenkins & Conrader. In September, 1895, the entire property of the firm was sold under execution by the Sheriff, and the partners became insolvent. Jenkins left the State and thereafter remained away, but Conrader entered into the hotel business, in which he incurred $900 worth of debts. On December 10, 1900, five years after the dis-

solution of the firm, Conrader was adjudged a bankrupt. From the sale of Conrader's individual property a fund of $1201 was realized, which the Referee awarded *pro rata* to firm and individual creditors. The Appellate Court affirmed this distribution and based its decision upon the two cases of *U. S. v. Lewis,* 13 N. B. R. 33 (affirmed in 92 U. S. 618), and *In re Downing,* 7 Fed. Cas. No. 4044. Reference to these cases show that the opinion in *U. S. v. Lewis,* was not based upon any bankruptcy act or partnership insolvency, but upon the application of an ancient statute of March 3, 1797, which made the United States a preferred creditor in all classes of cases. *In re Downing,* the partnership was dissolved in 1868, and at the time of dissolution, Downing agreed to pay off and discharge the partnership debts, giving to his partner notes for his interest in the concern amounting to $40,000. After dissolution, Downing continued the business in his individual name until August 16, 1869, during which time he disposed of part of the goods of the firm, paid off some liabilities, and contracted further liabilities. Downing was adjudged a bankrupt, but the partnership was never adjudicated a bankrupt as such. It will be noticed, the facts were unusual; *the firm was not in bankruptcy.* One of the individual partners had obligated himself or had assumed for himself the payment of the firm debts. In the present case before this Court, no unusual facts are shown or special equity claimed. As a matter of fact, the assets of the individual estate for distribution represents proceeds of life insurance policies which the individual partner had upon his life, and which policies were payable to his estate.

It is submitted that the ruling of the Third Circuit is in conflict with the express terms of section "f" of the Bankruptcy Act; is contrary to the decisions of all the other Circuit and District Courts in which the

question here raised has been considered; that Conrader v. Cohen, supra, relied upon to support the decision of the Court is based upon unusual facts which do not exist in the present case; and that the cases cited in Conrader v. Cohen do not support the rule of distribution there laid down.

VI.

CONCLUSION.

Distribution must be made in strict compliance with clause "f", that is, the creditors of the individual partners are entitled to priority in the distribution of such partners individual estate. The existence or non-existence of firm assets does not permit or admit of exception to this positive rule. This Court has so ruled when it practically refused to review the decisions of the Appellate Courts in the Second and Fourth Circuits, in the cases of *MacNabb, Trustee, v. The Bank of LeRoy*, and *Euclid National Bank v. Union Trust and Deposit Company, Trustee, supra.*

Further this Court has recognized the rule of distribution as above stated to be the established rule and has denied that any exception to the general rule, known as the English exception, exists, *Murrill v. Neill*, supra.

The decided weight of authority requires distribution to be so made, in strict compliance with clause "f"; the non-existence of firm assets for distribution does not create an exception to the general rule. Three Circuit Courts of Appeals and four District Courts of other circuits have so ruled. The only decisions

to the contrary under the Act of 1898, are *Conrader v. Cohen, supra,* and *In re Green,* 116 Fed. 118 (D. C. Iowa), but the facts in each of these cases were unusual and the decisions based upon such unusual facts.

VII.

It is, therefore, respectfully urged that the question certified to this Court ought to be answered in the affirmative.

Respectfully submitted,

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Counsel for Petitioners-Appellants.

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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1915.

No. 291.

The Farmers' and Mechanics' National Bank of Philadelphia,
Petitioner-Appellant,

vs.

Ridge Avenue Bank and Chester P. Ray, Trustee of the Estate of William J. Gray, Peter Gray and Alexander J. Gray, Individually and as Co-Partners trading as William Gray & Sons, Bankrupts,
Respondents-Appellees.

ON A CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

Brief on behalf of Respondents-Appellees.

FRANK R. SAVIDGE,
Counsel for Respondents-Appellees.

ALLEN, LANE & SCOTT, PRS., PHILADELPHIA.

INDEX.

	PAGE
Argument	1
The equitable principle contended for by Respondents is supported by the best authority	1
The principle is also supported by reason and equity	16
Authorities, text writers	3
Bankruptcy Act of 1898, sec. 5, clauses "f" and "g"	2
Bankruptcy Act of 1867, sec. 36	4
Cases cited and discussed:—	
Carpenter, *in re*, 7 Mor. Bank. Cas. 270	4
Case *vs.* Beauregard, 99 U. S. 124	18
Conrader *vs.* Cohen, 121 Fed. 801	5-6
Collier, *in re*, Fed. Cas. 3002	5-6
Daniels, *in re*, 110 Fed. 745	8-12
Downing, *in re*, Fed. Cas. 4044	5-6-11
Euclid Nat. Bank *vs.* Trust Co., 149 Fed. 975	3-12
Fitzpatrick *vs.* Flannagan, 106 U. S. 648	18
Francis *vs.* McNeal, 228 U. S. 695	14
Gray, *in re*, 208 Fed. 959	9
Green, *in re*, 116 Fed. 118	6-12-17
Harris *vs.* Peabody, 73 Me. 262	5
Hull, *in re*, 224 Fed. 796	8-12
Janes, *in re*, 133 Fed. 912	3-11
Jewett, *in re*, Fed. Cas. 7304	6
Kane, *in re*, 11 Am. B. R. 533	14
Knight, *in re*, Fed. Cas. 7880	6-17
Litchfield, *in re*, 5 Fed. 47	5
Lloyd, *in re*, 22 Fed. 89	7
McCulloh *vs.* Dashiell, 1 H. & Gill 97	15
McEwen, *in re*, Fed. Cas. 8783	5-6
Miller *vs.* Fertilizer Co., 211 U. S. 496	14
Mills, *in re*, 95 Fed. 269	14
Mills *vs.* Fisher & Co., 159 Fed. 897	3-14
Murrill *vs.* Neill, 8 How. 414	14
Rice, *in re*, Fed. Cas. 11750	6
Taitt, *ex parte*, 16 Ves. 193	4
United States *vs.* Lewis, 92 U. S. 618	8
Wilcox, *in re*, 94 Fed. 84	12
English Courts sustain the principle	4
State Court decisions	16

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Respondents-Appellees.

BRIEF OF ARGUMENT ON BEHALF OF RESPONDENTS-APPELLEES.

THE EQUITABLE PRINCIPLE, COMMONLY CALLED AN EXCEPTION TO THE GENERAL RULE, THAT FIRM CREDITORS SHARE EQUALLY WITH SEPARATE CREDITORS OF THE PARTNERS IN INDIVIDUAL ASSETS, WHERE THERE ARE NO FIRM ASSETS AND NO LIVING SOLVENT PARTNER, IS SUPPORTED BY THE BEST AUTHORITY.

Section 5, sub-divisions *f* and *g* of the Bankruptcy Act of 1898 (30 Stat. at Large, Chap. 541, page 544), reads as follows:—

> ("*f.*) The *net proceeds* of the partnership property shall be appropriated to the payment of the partnership debts, and the *net proceeds* of the individual estate of each partner to the payment of his individual debts. Should any surplus remain of the property of any partner after paying his individual debts, such surplus shall be added to the partnership assets and be applied to the payment of the partnership debts. Should any surplus of the partnership property remain after paying the partnership debts, such surplus shall be added to the assets of the individual partners in the proportion of their respective interests in the partnership.
>
> "(*g.*) The Court may permit the proof of the claim of the partnership estate against the individual estates and *vice versa*, and may *marshal* the assets of the partnership estate and individual estates so as to prevent preferences and secure the *equitable distribution* of the property of the several estates."

This enactment is obviously merely an affirmance of the equity branch of the common law which always has so administered such assets, and it is a part of that long-established doctrine, commonly referred to as an exception to the general rule of administration, that where, as in this case, there is no partnership property and no solvent living partner, the partnership creditors share *pari passu* with the individual creditors in the individual assets of the partners. There is nothing in this Act which changes that doctrine; if the Act had intended to change such a thoroughly well established rule of administration, it would have been careful to express the change. The Act has application to the fact that a partner usually owns both partnership and private property. Indeed, it might almost be said that this sec-

tion is inapplicable in the rare instance where, as here, the partner is possessed of but one kind of property. The Act itself, in treating of the contingency of surplus "of the partnership property" remaining "after paying the partnership debts" shows it was declaring the rule where there were *partnership* as well as individual assets.

That this doctrine, referring particularly to the exception, so called, is a universal and firmly settled principle of distribution in such cases is recognized by all of the leading authorities on the subject of partnership.

Lindley on Partnership (8th Ed.) page 811 note; 855;
Gilmore on Partnership page 438-9;
Parsons on Partnership (2nd Ed.) page 500;
Collyer on Partnership (6th Ed.) page 1459;
Storey on Partnership (7th Ed.) sec. 380;
See also Loveland on Bankruptcy (1912), sec. 273;
Bispham's Principles of Equity (9th Ed.) sec. 517.

Parsons states that the case of there being no firm estate should be considered as outside of, rather than an exception to, the general rule.

Indeed, there is really nothing in the adjudicated cases overthrowing the doctrine, although some Courts, it is true, comparatively within recent years, as for instance, *In re* Janes, 133 Fed. Rep. 912, Euclid Nat. Bank *vs.* Union Trust & Dep. Co., 149 Fed. Rep. 975, Mills *vs.* Fisher & Co., 159 Fed. Rep. 897, and a few others, cited by appellant, losing sight of the intent and purpose of the Act, have adopted the narrow view that as the Act contains no express provision as to the manner of distribution to be followed in the absence of firm property, the application of the principle, more than a century old, of permitting firm creditors in such event to participate equally with separate creditors in separate assets would be "judicial legislation" (Judge Lacombe, in *In re* Janes, *supra*), and "to ingraft

upon the Act" an exception (Euclid Nat. Bank *vs.* Union Trust & Dep. Co., *supra*). The error of this view is shown hereafter, in discussing these cases.

In England the exception has been sustained in equity since the beginning of the nineteenth century. Our Bankruptcy Act of 1898 respecting distribution of firm and separate property is practically a duplication of the English Bankruptcy Act of 1883, which contains no express exception to the general rule, therein contained, but English Courts universally apply the exception, where there is no firm estate and no solvent living partner.

Lindley on Partnership (8th Ed.) page 855;
Re Carpenter, 7 Morrell Bankr. Cas. 270;
Ex parte Taitt, 16 Vesey, Jr., 193.

In the United States, the majority of the decisions on this question have been rendered under the Bankruptcy Act of 1867, Section 36 of which is substantially the same, respecting distribution of firm and individual assets, as the corresponding Section 5 of the Act of 1898. Section 36 of the Act of 1867 reads as follows:—

> "And after deducting out of the whole amount received by such assignee the *whole of the expenses and disbursements*, the *net proceeds* of the joint stock shall be appropriated to pay the creditors of the co-partnership, and the *net proceeds* of the separate estate of each partner shall be appropriated to pay his separate creditors;
>
> "And if there shall be any balance of the separate estate of any partner, after the payment of his separate debts, such balance shall be added to the joint stock for the payment of the joint creditors;
>
> "And if there shall be any balance of the joint stock after payment of the joint debts, such balance shall be divided and appropriated to and among the separate estates of the several partners, according to their respective right and interest therein."

It has been decided that Section 36 of the Act of 1867 is simply declaratory of the formerly established rule in equity as to distribution of firm and separate assets.

> "It is no innovation, but merely an expression, in peculiarly felicitous language of the ancient equity practice of marshaling and distributing assets."
>
> *In re* Collier, Fed. Cases 3002; 12 N. B. R. 266 (1874).

The above mentioned provisions of both the Acts of 1898 and of 1867 respecting distribution of firm and individual assets in the case of partnerships are substantially the same.

Conrader *vs.* Cohen, 121 Fed. 801 (1903).

The term "*net proceeds*" used in the Acts, means the fund remaining after payment of expenses of administering the estate in bankruptcy; in other words, assets distributable to creditors.

In re Litchfield, 5 Fed. Rep. 47 (1880);
In re McEwen, Fed. Cas. 8783; 12 N. B. R. 11 (1875);
See also Gilmore on Partnership, page 440.

Where, as here, proper administration expenses consume the entire firm assets, leaving *no net proceeds* of firm property for distribution to creditors, the situation is that there is no partnership fund whatever,—in this case there is only the fund of an individual partner's estate before the Court for distribution. *In re* Litchfield (*supra*), *In re* McEwen (*supra*), Harris *vs.* Peabody, 73 Me. 262. No necessity exists for mashaling assets, alloting firm proceeds to firm creditors and individual proceeds to individual creditors, as when two funds are before the Court for distribution (*In re* Downing, 3 N. B. R. 748; Fed Cas. 4044): the equitable exception at once applies and both firm and individual creditors share equally in the one fund.

Under the Act of 1867 the weight of authority, following the English doctrine, supported this principle as a part

of the long established equitable method of distribution, and allowed firm creditors to participate in separate assets *where there was no partnership fund for distribution*, and this, regardless of whether the partnership was in bankruptcy or not. This method of distribution, the Courts held, tended to produce the equality which it was the manifest purpose of the Act to secure.. Cases supporting it are

In re Jewett, 1 N. B. R. 491; Fed. Cas. No. 7304;
In re Knight, 8 N. B. R. 436; Fed. Cas. No. 7880;
In re Downing, 3 N. B. R. 748; Fed. Cas. No. 4044;
In re Rice, 9 N. B. R. 373; Fed. Cas. No. 11750;
In re McEwen, 12 N. B. R. 11; Fed. Cas. No. 8783;
In re Collier, 12 N. B. R. 266; Fed. Cas. No. 3002.

Under the Act of 1898, although there is a conflict in the decisions among Circuit Courts of Appeals and the lower Federal Courts, it is submitted that the Courts which have considered the matter, as should be done, in the light of its equitable foundation and development, and kept in mind the intent and purpose of the Bankruptcy Act, have sustained the exception where the facts were substantially as in this case.

In the case of *In re* Green, 116 Fed. Rep., 118; 8 Am. B. R. 553 (D. C. of Ia), it was decided that where there is no solvent partner and no firm assets, firm creditors may share with individual creditors of the partner. In this case there was only one fund for ditribution, there being no partnership assets or partnership adjudication, but the Court followed the broad equitable principle that the firm creditors should not be denied the right for this reason to go against the individual assets.

The Circuit Court of Appeals for the Third Circuit, the jurisdiction from which the case at bar arises, sustained the exception in a well considered case, Conrader *vs.* Cohen, 121 Fed. Rep. 801 (1903), affirming the District Court decision reported in 118 Fed. Rep. 676. The facts

were briefly that Jenkins and Conrader traded as a partnership; in 1895, the entire firm property was sold under execution and the partnership and individual partners were insolvent. Thereafter Conrader went into business for himself, and in 1900 became bankrupt. This Court, in affirming the District Court and the award of the Referee, held that the firm creditors of Jenkins and Conrader were entitled to share equally with the individual creditors of Conrader in the distribution of his individual assets, which comprised the *only fund before the Court for distribution, there being no partnership property.* The lower Court held that the statutory provision in the Bankrupt Act merely expressed the general rule governing the equitable distribution of such funds and cited the opinion of Judge Acheson in *In re* Lloyd (D. C. E. D. Pa.) 22 Fed. 89, to the effect that the rule must be strictly followed of applying firm assets to firm creditors and individual assets to individual creditors only *where the joint estate, as well as the separate estate, is before the Court for distribution.*

The Circuit Court, in an opinion by Judge Acheson, 121 Fed. 802, affirming the lower Court, said:—

> "It will be perceived that a *single fund* only, *derived from this separate estate* of the bankrupt, Conrader, was *before the Court for distribution;* that *all the property of the firm of Jenkins & Conrader had been sold* upon execution in the year 1895, and passed to the sheriff's vendee; that the partnership is not in bankruptcy; that there are *no firm assets;* and that there is *no solvent partner.* The insolvency of Jenkins in 1895 having been shown, that condition will be presumed to have continued, in the absence of any evidence to the contrary. If his financial condition changed, it was for the contesting individual creditors to show it. Upon the facts here appearing, why should not firm creditors participate in the fund before the Court? It is the *only fund available to any of the creditors. Now, it is well settled that each partner is debtor to the creditors of*

the firm. In equity, as well as at law, partnership debts are treated as several, as well as joint. Upon principle, we think the District Court was right in admitting the partnership creditors to participate pro rata with the individual creditors in this fund.

"We find *abundant authority* to sustain the decision of the Court below. In United States *vs.* Lewis, 13 N. B. R. 33, Fed. Cas. No. 15,595, it was held by Mr. Justice Strong and Circuit Judge McKennan that the rule that the joint estate must be applied to pay joint debts and the separate estate to pay the separate debts, is *only applicable where the joint estate, as well as the separate estate, is before the Court for distribution*, and in the same case upon appeal (Lewis *vs.* United States, 92 U. S. 618, 23 L. Eq. 513), the Supreme Court, speaking by Mr. Justice Swayne, said, '*A court of equity will not entertain the question of marshaling assets unless both funds are within the jurisdiction and control of the court.*' In the case in hand two funds do not exist."

The appellant seeks to detract from the importance of this decision by stating the "facts were unusual," and to distinguish the case of Conrader *vs.* Cohen from the case at bar on the ground that there the firm was not in bankruptcy, while here it is; yet the Court in the Conrader case did not lay stress upon this fact, the vital element being absence of firm assets for distribution, leaving but one individual fund. Many of the cases, including Euclid Bank *vs.* Union Trust Co., 149 Fed. Rep. 975; *In re* Daniels, 110 Fed. Rep. 745; *In re* Hull, 224 Fed. Rep. 796, cited by appellant against the equitable principle herein contended for, are "unusual" in the same respect as the Conrader case, the firm not being in bankruptcy; but this fact is not material. Judge Buffington, in deciding the Conrader case in the District Court (118 Fed. 676), after discussing the cases cited in his opinion, and passing upon the turning point of the case, which was that there was no

firm property but only one fund before the Court for distribution, said:—

> "*Apart* from the constraining force of these decisions, we see no reason why, under the facts of this case, the partnership debts should not participate in this fund. Personal liability for them arose when they were incurred. Exhaustion of the firm's assets made this personal liability and the property of the individual partners the sole source to which recourse could be had for payment. Under these conditions, and with this individual liability of Conrader's impending, the complaining creditors chose to grant him further credit. Such being the case, there is no equitable reason why the individual liability then resting on Conrader to pay these pre-existing firm debts should be postponed in enjoyment or affected in realization because thereafter he created other and purely individual ones."

It is clearly shown that Judge Acheson had in mind as the vital and turning point of the case the absence of firm assets and the fact that but one fund was available for creditors, for he not only mentions that first in his opinion, but later emphasizes it in stating that the firm creditors should participate in the fund before the Court, because "*it is the only fund available to any of the creditors,*" and each partner being jointly and severally a debtor to the firm creditors, it would be proper to admit the firm creditors to participate with the individual creditors in that fund. The fact that there may have been firm assets in the beginning, if they were consumed as in the case at bar by proper administration expenses, is not material, because the test is, are there any partnership funds available for *distribution to creditors?*

Judge McPherson in the opinion rendered by the District Court in the case at bar (*in re* Gray, *et al.*, 208 Fed Rep. 959) correctly stated the controlling principle in the Conrader case, which he declared ruled this case, when he said (page 960):—

> "It is true that the partnership there was not in bankruptcy and that the only fund before the Court for distribution was the fund produced by the separate estate of one partner; but, as I understand the reasoning of the opinion, it proceeds upon the ground (which was established by the evidence) that *no solvent partner existed and no partnership property either in Court or out of Court.* It does not proceed upon the ground that only one fund was in Court: namely, the separate estate of one partner; but upon the ground that the Court knew that no firm porperty was to be found anywhere, and no solvent partner."

As in the Conrader case, so in the case at bar, there is no solvent partner, there are no firm assets for distribution to firm creditors, and there is noly one fund, the assets of an individual partner, for all creditors.

Appellant would further make it appear that the case of *In re* Downing, Fed. Cas. No. 4044, cited with approval in the Conrader case, is inapplicable in that, the firm not being in bankruptcy, the bankrupt partner had expressly obligated himself to pay the firm debts, and hence firm creditors should participate in his separate estate; but the Court declared that if this were not so, yet under the Bankruptcy Act, applying the equitable exception, the firm creditors would be entitled to share in the separate estate.

In the case of *In re* Janes, 133 Fed. Rep. 912 (1904), (Circuit Court of Appeals, 2d Cir., New York), cited by Appellant against the exception, two partners and their firm were adjudicated bankrupts; the partners had assets; the firm had only $10 in assets, but the Trustee reported no firm assets. The Court, it is true, excluded firm creditors from participation in the individual assets of the partners until separate creditors were paid. Judge Lacombe taking the narrow view, and evidently disregarding the intent and purpose of the Act, reading its letter and not its spirit, said:—

"It was within the discretion of Congress to leave this subject of the marshalling of assets to the Courts, to be disposed of in accordance with equity principles and practice, or to provide that the general rule should be modified in particular cases. It has done neither. On the contrary, it has itself directed how the assets shall be marshaled, and it has done so in language broadly covering this case, as well as all the others. The language is plain, explicit and unambiguous; it names no 'exception;' its phraseology conveys no intimation that any 'exception' is contemplated. *To inject into the act an excepting clause where none has been enacted would seem to be judicial legislation.*"

The error of the conclusion reached by that Court from this statement is apparent in the simple consideration that Congress was declaring and adopting itself the known equitable principle of marshaling and distributing of assets, and that there is no "modification" of the general rule in the determination that when there are no partnership assets the rule is inapplicable. It is more reasonable to assume, as stated by Loveland on Bankruptcy, Section 273, that when Congress adopts a rule (as contained in the Bankruptcy Act), of administering partnership property, which has received practically a uniform construction, allowing the exception, from very early times, it is presumed that it intends the same construction placed on its language unless it expressly declares otherwise. Furthermore, the very statement of the Court that "to inject into the Act an excepting clause where none has been enacted would seem to be judicial legislation," indicates but a superficial view of the question, as the recognition and application of a century old doctrine not inconsistent with the general rule as intended by the Act, could not in any respect be deemed judicial legislation.

The fact that a petition to this Court for a writ of certiorari in the Janes case, as also in the case of Euclid Nat. Bank *vs.* Union Trust & Dep. Co. (*supra*), was denied, no reason for its denial appearing, does not affect the issue in this case.

In Euclid Bank *vs.* Trust Co. (*supra*) the Court also considered the strict letter, rather than the spirit of the law, and based its decision on the erroneous reasoning in the Janes case, stating that "To ingraft upon the act the exception sought to be maintained by the petitioner would be manifestly improper on the part of the Court, and in the language of Judge Lacombe *in re* Janes, *supra*, would be judicial legislation."

In *in re* Hull (*supra*) the Court speaking of Section 5 of the Act emphasized the narrow view, losing sight entirely of the underlying equitable principles, and stating the language of the section did not permit the "grafting of an exception," and that,—

> "The language, *read literally*, excludes opportunity for the partnership debts to participate in the fund derived from the individual estate of a partner, except as provided in the subsequent sentence of the paragraph; that is, only when the individual estate yields a surplus above the individual liabilities."

The Court finally based its decision upon the doctrine of the Janes case, concluding that the Act was "so definite as to provide a uniform rule of distribution, against which there can be no exception introduced by judicial construction."

The case of *In re* Daniels (*supra*) was decided merely on authority of *In re* Wilcox, 94 Fed. Rep. 84, an early case decided against the exception by the District Court of Massachusetts, and which decision is disapproved and severely criticised *In re* Green, 116 Fed. Rep. 118 (District Court of Iowa), referred to hereafter.

The exhaustive and interesting opinion of Judge Lowell, covering thirty-five pages, in the Wilcox case, giving the history and development of the law, is cited and relied on by practically every subsequent case denying the equitable principle herein contended for; but it is equally as interesting to note when the learned Judge comes to apply the learning to the law in this country, while showing by his

citation of cases that the decided weight of authority here under the Act of 1867 upheld the principle, yet takes the view that the Act of 1898 is materially different from the former Act, and under the present Act the principle cannot stand. While it is true that this observation may be had, that some portions of the two Acts differ, yet the particular sections hereinbefore mentioned, respecting the distribution of partnership property, and which stand by themselves, are almost identical; their intent and effect are the same (Conrader *vs.* Cohen, *supra*). Furthermore, the learned Judge is lead into the same error which has uniformly controlled those Courts denying the application of the principle, which is the erroneous view that as the "plain language" of the Act recognizes no exception, the principle cannot be applied; whereas there is no difficulty as to the clear meaning of the words of the Act in affirmation of the well known doctrine, but there is difficulty when one loses sight of the consideration of the facts as to whether the words have applicability to a situation not contemplated, especially when to make them applicable would strike down a well known principle of equity. As a strict constructionist, the Judge departs from the rule of the construction of words of a statute in codification, that unless a known rule is inconsistent therewith, it is in keeping with the plain intent and words of the Act not to distort them in an isolated construction of their meaning the very opposite of that which was intended. This is exemplified in some cases arising under the Negotiable Instruments Law adopted throughout the country, cases not provided for therein being ruled by the law merchant. Upon the recognition of this broad equitable principle the wholesome rule of distribution of assets stands.

The Courts which adopt the narrow view, as in the Wilcox case and those following it, disregard not only the equitable principles underlying the Bankruptcy Act, but also the fact that a Bankruptcy Court is one of equity, administering the law, not merely according to the letter, or as "read literally," but according to its spirit, and lose sight

of the fact that the Act is not antagonistic to, but is in support of the equitable principle aforesaid.

In re Kane, II Am. B. R. 533.

In re Mills, 95 Fed Rep. 269, cited by appellant, is not an authority against the exception where the facts are as in the case at bar. In the Mills case the Court held, and rightly, that it would be inequitable to permit creditors of a firm, insolvent and dissolved under a State law, who had received 55 per cent. of their claims in dividends from the firm estate, to participate in the separate estate of one of the bankrupt partners before his separate creditors were paid; the Court was careful to say it would "not now decide that there may not arise cases under which the exception" may apply.

In Mills *vs.* Fisher & Co., 159 Fed. Rep. 897, cited by appellant, the question of the exception applying was not directly in point, and the Court disposed of it by merely saying it could be conceded upon the authority of *In re* Wilcox (*supra*) that the separate creditor would have priority as to separate assets independently of the existence of firm assets.

The references to Section 5 of the Bankruptcy Act of 1898 made in Miller *vs.* Fertilizer Co., 211 U. S. 496, and Francis *vs.* McNeal, 228 U. S. 695, cited by appellant, are statements of the general rule where there are both classes of assets.

The case of Murrill *vs.* Neill, 8 Howard, 414 (1850), cited by appellant, was decided upon a very different situation from the case at bar. There firm creditors filed a bill in equity claiming the right to participate in one of the partner's separate estate with his separate creditors. In that case, unlike the present, there was a partnership fund from which the claimants, firm creditors, had received a portion of their claims, and in which event of course the exception would not apply. The Court held that the firm creditors were precluded from sharing in the separate assets of the bankrupt partner Tiernan, by reason of the provisions of a

deed of trust executed by Tiernan, appropriating all of his separate property to his creditors, meaning, the Court held, separate creditors. The partnership creditors then contended they should be allowed in equity to participate in the separate fund with the separate creditors, and Mr. Justice Daniel, in discussing the general rule of distribution of applying firm assets to firm creditors and individual assets to individual creditors, which he said had existed from very early times in England and America, took occasion to comment upon the exception of allowing firm creditors to share separate assets with separate creditors in the absence of firm assets and said it did not seem to have been followed in this country, and approved the rule aforesaid, quoting Storey on Partnership, saying:—

> "It is a general rule, that the joint debts are primarily payable out of the joint effects, and are entitled to a preference over separate debts of the bankrupt; and so, in the converse case, the separate debts are primarily payable out of the separate effects, and possess a like preference; and the surplus, only after satisfying such priorities can be reached by the other class of creditors."

It must be remembered, however, that Storey recognizes the exception as well as the rule (2d Ed. Storey on Partnership, sec. 363; also 7th Ed. page 380), a fact which the Court did not seem to note.

The language, therefore, of Justice Daniel, in regard to the so-called exception, is but his own dictum; it was not necessary to the decision of that case to consider the exception; there were firm assets available for firm creditors, wherefore the general rule and not the exception would govern. Furthermore, the opinion was written at an early day, some sixty-five years ago, before there had arisen many instances for the consideration of the rule, or at least the exception, in this country, and was apparently based on the decision in the case of McCulloh *vs.* Dashiell, 1 Harris & Gill's Rep. 97, rendered in 1827 in the Court of Appeals of Maryland, in which the Court, while expressly recognizing

the principle as "the settled and established rule," both in bankruptcy and in equity, yet held it would not apply in that case because there were partnership assets; but in commenting upon the matter, stated, as dictum, that if this were not so the Court would be disposed to adopt the ancient rule refusing to permit firm creditors to share individual assets with individual creditors, if such assets were insufficient to pay individual creditors, irrespective of whether there was any partnership fund or not. The exception did not, on the facts of that case, come before the Court for decision; the case was decided by applying the general rule, which is not disputed.

No decision of the Supreme Court, either in equity or in bankruptcy, has been found, deciding the question as here raised, based on facts identical with or similar to those in this case.

Since the opinion of Justice Daniel was rendered, the majority of the Federal Courts, under the Bankruptcy Act of 1867, and those which it is submitted have given the Act of 1898 the proper equitable construction, have supported the exception, and it is significant that the great majority of the States of the Union sustain the exception in distributing insolvent partnership and individual estates in equity. Among the States allowing it are Alabama (Smith *vs.* Mallory's Exrs., 24 Ala. 628); New Jersey (Davis *vs.* Howell, 33 N. J. Eq. 72); Missouri (Level *vs.* Farris, 24 Mo. App. 445; Hundley *vs.* Ferris, 103 Mo. 78); Rhode Island (Colwell *vs.* Bank, 16 R. I. 288); Wisconsin (Thayer *vs.* Humphrey, 91 Wis. 276); Maine (Harris *vs.* Peabody, 73 Me. 262); Ohio (Rodgers *vs.* Meranda, 7 Ohio St. 179).

THE SO-CALLED EXCEPTION IS SUSTAINED BY REASON AND EQUITY.

Partnership creditors, having at law recourse to both firm property and the separate property of the partners in satisfaction of their debts, and creditors of the separate partners having recourse ordinarily to but the separate property, the general rule mentioned developed from the equitable

principle that he who has two funds from which to satisfy his demands will not be allowed to appropriate that one to which another creditor is limited. The reason for the exception is to be found in the reason for the rule itself; if there be no firm property and no living solvent partner, but only the property of one of the partners, there is no advantage enjoyed by the firm creditors over the separate creditors; the firm creditors, like the separate creditors, have but the one fund available, and should be permitted to share therein equally with the separate creditors.

Gilmore on Partnership, p. 439;
In re Knight, 8 N. B. R. 436; Fed. Cas. No. 7880.

The so-called exception is further in accord with reason and justice, in that persons dealing with firms do so quite as much upon the credit of the separate partners as of the firm; the partners, to the extent of their separate as well as firm property, if that be insufficient, are liable for firm debts, and it would be most inequitable to deny firm creditors, in the absence of firm assets, any participation in separate assets, until separate creditors be fully paid, which in most cases would deprive firm creditors of any payment, as there is seldom enough separate property, on insolvency, to pay separate creditors alone. It is no answer, in an attempt to discredit the exception, to say that each class of creditors should be confined strictly to its own particular fund, on the theory, so often advanced by opponents of the exception, that joint creditors give credit to the joint estate and the separate creditors to the separate estate; joint creditors quite as frequently give credit to the separate estates.

The extreme injustice which the strict application of the rule, without the exception, may cause is well stated by the Court in *In re* Green, 116 Fed. Rep. 118. It is there stated that the equities of the firm creditors to have firm assets appropriated to their debts, being derived from the equities or right of the partners to have their partnership effects applied primarily to partnership obligations (citing Fitzpatrick

vs. Flannagan, 106 U. S. 648; Case *vs.* Beauregard, 99 U. S. 124) subsists so long as the partners' rights in this respect remain; and it is indispensable to the relief of firm creditors that the firm property be before the Court; that if, as may be and often is the case, the firm assets are by act of the partners themselves transferred to one of them or to another party, there is no other fund for the firm creditors, and the practical result of the rule, as declared in *In re* Wilcox (*supra*), denying the exception, would be that in all cases where the equity of the firm creditors has been destroyed by the action of the partners in converting the firm property into individual assets, the individual creditors are entitled to be preferred, and are entitled to exclude the firm creditors from sharing in those assets, even though they were originally the property of the firm.

Finally, the Act of Congress, which merely embodies time-honored principles of the distribution of assets employed by the Courts of Equity—and Bankruptcy Courts are Courts of Equity—repeals or amends none of such principles, and, conversely, it cannot be said that the Act is modified, or amended or repealed by judicial legislation or otherwise in recognizing the equitable principle herein contended for, when it is not antagonistic to the Act, but a part of and operating in harmony with the equitable method of procedure of which the Act is an affirmance. It is submitted that upon reason, justice and the precedent of well considered authorities, the so-called exception, in reality the principle, which has never been abrogated or repealed, should be sustained, and the question here certified should be answered in the negative.

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